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# Exploring “Bay” in Search of New Dimensions for Accounting Theory and Standards

Shaukat Amer<sup>1\*</sup> Prof. Dr. Raja Suzana Raja Kasim<sup>2</sup>

1- COMSATS Institute of Information Technology, Kamra Road, Attock, Pakistan.

\*E-mail of the corresponding author : [shaukat\\_amer@comsats.edu.pk](mailto:shaukat_amer@comsats.edu.pk)

2- Director Research & Innovation Management Center Universiti Kelantan Malaysia and Head of Unit, Research Management Global Entrepreneurship Research & Innovation Center, Malaysia.

The accounting standards prepared and issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are specifically meant for Islamic financial Institutions and hence limited in application. Moreover, in most of the cases the Islamic financial institutions have not adopted these standards and their accounts are still being prepared and reported under IFRS or GAAP or National or a mix of these standards. Under the circumstances there is a need of a complete set of standards based on Islamic teachings which can replace the conventional accounting standards in the Islamic world. The subject matter of “bay” is very vast. The “Hadith” on “bay” mainly deals with the valuation aspect of business transactions. The topics covered under “bay” can be classified according to the nature of the transaction. Each topic can be converted into a separate accounting standard. In this respect the Islamic principles of “Amanah” (Custody) (Amer, 2007), “Shahadat” (Testimony) (Amer, 2007) settlement in “Bay” (business deal), “Shura” (Counseling) (Amer, 2010) and “Adal & Ihsan” (Amer, 2013) can provide a solid theoretical foundation. Moreover, by default, such Islamic concepts are integrated parts of concept of “bay”. The purpose of this paper is to explore the concept for a new set of accounting standards.

**Key Words** A new Accounting Theory, A new set of accounting Standards, Islamic teachings, “Bay”,

## 1-Introduction

The major functions which are attributed to accounting include keeping safe custody of interests of all the stake holders, certifying the true and fair view of business, providing reliable information to the stakeholders for successful decision making and enabling accountability. In this context, however, the core issue of correct valuation of transactions by the present accounting theory and standards is yet to be addressed. The present conventional accounting theory and accounting standards deals only with the valuation aspect of transactions. However, it is now being debated that accounting should also deal with the accountability aspect of business transaction also (e.g. Colson, 2005, Ibrahim, 2005, Mele, & Josep, 2005, Amer, 2012) without which the correct valuation of transaction is not possible. Even the word of “Ethical Accountant” is being used in the backdrop (Kearney, 2005).

Accounting theory based on Islamic principles like “Amanah” (Custody) (Amer, 2007), “Sahadat” (Testimony) (Amer, 2007) “Shura” (Counseling) (Amer, 2010) and “Adal & Ihsan”. (Amer, 2013) can provide a solid foundation for development of a new set of accounting standards. This will also enhance the delivery of correct valuation of a transaction

The true role of accounting starts with its scare role of a custodian of interests of all the stakeholders. In Islam the concept of “Amanah” is very broad and it ensures correct valuation of transactions. Let us have a look on some of important definitions of the concept of different religious scholars. “Amanah is not only what we perceive rather everything is Amanah which is subject to someone’s right and its safe custody and repayment is mandatory”(Aslam). In IIEE’ Blueprint of Islamic Financial System (1999) it is defined as, “Keeping something in trust —for safe-keeping only.” Hazrat Abdul Qadir Gilani (Rasheed, 1994) defined “Amanah” as:

“What is “Amanah”? To keep in custody other’s belongings by sacrificing own wants. No wants in the universe or if have than staying firm on the same. The human wants are in conflict with “Ahkams” on the subject. Keeping custody of other belongings in lines with “hukamh” against owns want require a lot of energy. This result that those denied should be taken to task and those who embraced may be forgiven. Now it is still valid that if someone deliberately destroys belongings in his custody, he should repair the loss and if not deliberately, he should be spared.”

The Islam has a unique concept of certification which is called “*Shahadat*”. The meaning of “*Shahadat*” is testifying, absolute information, on the face of it and open. (Numani, 1994) The person who acts on “*Shahadat*” is called “*shaheed*”. The “*shaheed*” may be a testifier, an observer, guardian and verifier (Numani, 1994). The spirit of certification should be as quoted by Sheik Aziz in the following words:

“The criterion that you must adhere to is that of truth, even if you must stand alone”

Molana Modoodi is a great Muslim scholar. In one of his books he says “The importance of this testimony may be noted from this that the system for accountability and punishment & reward which Allah has enforced for humanity is entirely based on this testimony” (1946).

In Islam the concept of “*Al-adl*” is a leading and guiding principle. It is an important pillar on which foundation of Economics and business can be laid down. The concept of “*Al-ihsan*” is also very important. Like universe if there is no “*Adl*” in any phase of life or a discipline or a profession, it would be deficient and defective. This is equally true in case of accounting theory and practice. For example the concepts of “*Al-adl*” and “*Al-ihsan*” totally discard earnings management.

“Although the words “*adl*” (justice) and *ihsan* are concurrently used in the Quarn (16:80), their concept is different from each other. ‘*Adl* is a legal concept while *ihsan* is a moral one. The latter means benevolence, fineness, proficiency, or magnanimity in dealing with others. It implies a more liberal treatment than what justice demands. Apparently it seems to be a supererogatory virtue but the Quranic injunction suggests that the attitude of “*ihsan*” enjoys a significant position in the Islamic framework” (Zaman, 1999).

Let us discuss these principles more specifically in the context of accounting practices. Take the example of depreciation. Here we used different methods and different rates. The management and accountants can use their discretion while formulating accounting policies on depreciation. This discretion may bring different financial results. Again here the concept of deferred taxation may be against the spirit of concept of “*Aladl*” as it may deprive the stake holder specially the investors from profit on a particular time. Similarly the write off polices may bring different results. For example in Pakistan the banks have written off billions of rupees loans which adversely affect the profitability of these banks. Without going for deliberation on the “*ribah*” aspect of these transactions which is totally prohibited, the writing off loans is against the principle of *adl* and *ihsan* as we know that even the loan of a “*saheed*” cannot be written off. Likewise some time the claims of creditors, suppliers and employees are written back due to law of limitation or for any reason which is again against the norm of “*Adl and Ihsan*”.

Presently a lot of debate is going on the various aspects of adopting accounting standards. Some are arguing in favour of accounting standards based on GAAP and some are in favour of IFRS (See Benston, Bromwich and Wagenhofer ,2006; Tarca, 2004; Jamal and Sunder, 2007; Soderstrom and Sun; Goncharov & Zimmermann, 2002 and Bradshaw, & Miller, 2002). There is also a discussion going on regulatory competition among accounting standards and choice to select a specific set of accounting standards (Sunder, 2002). Than we also argue regarding harmonization of accounting standards. The joint efforts of IASB and FASB to develop a common conceptual framework although full of challenges (McGregor and Street, 2007), would be a landmark for accounting profession. However, the results of joint efforts of IASB and FASB are yet to be seen in the coming years. “More importantly, the boards need to ensure that the revised framework addresses comprehensively both initial and subsequent measurement. This should include a clear articulation of acceptable measurement bases as well as identification of the measurement attribute or attributes that when applied will produce the highest quality decision useful information” (McGregor and Street, 2007).

In the latest joint report ( February, 2013) the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB), reaffirmed their commitment to improving International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP) and achieving their convergence. All these efforts are to get high quality of accounting standards fit as a single set for the whole harmonized world. Convergence of accounting standards in the whole world is a good effort. However, there are still a lot of question marks in the way.

“Most of the short-term projects and several of the longer-term projects have been completed or are nearing completion. In 2012 the boards made significant progress on the remaining joint projects and they continue to appreciate the importance of developing converged accounting standards. The boards have achieved converged solutions for Revenue Recognition accounting and will be exposing converged proposals for accounting for Leases. There have, however, been some challenges to developing completely converged solutions, especially for the Impairment and Insurance Contracts projects “(IASB&FASB, 2013).

The real test of these standards would be when these standards would be put in to practice especially in terms of correct valuation of business transaction, true and fair financial reporting and accomplishment of aim of independence of accounting profession.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has prepared and issued a set of accounting standards in addition to “*Shariah*”, auditing and governance standards. But these are specifically prepared for Islamic financial Institutions. Another unfortunate aspect of these standards is that most of the Islamic financial institutions have not adopted these standards and their accounts are prepared and reported under IFRS or GAAP or National or a mixed of these standards. This itself negate and in conflict of the philosophy or basis of *Shariah*.

“Islamic banks operate mainly in developing countries in the Middle East, Africa and South-East Asia and are facing some difficulties adopting unique accounting standards into their practice due to the absence of a legal framework and inconsistency of financial reporting. For instance, financial institutions in some countries, such as Jordan, the UAE and Qatar, are officially required to comply with the International Accounting Standards (IASs). Meanwhile, in countries such as Saudi Arabia, the authorities require compliance with both IAS and local accounting standards. In Malaysia, there are national accounting standards, which are based on IAS (Ahmed, 2002). In Bahrain, the authorities require compliance with both AAOIFI and IFRS as requested by Central Bank of Bahrain (CBB)” (Sarea, 2012).

“It is apparent, therefore, that many aspects of the Islamic economy differ greatly from Western economies. Anglo-American accounting techniques cannot be readily applied in Islamic economies and thus, international accounting standards based on such techniques would create difficulties for Muslims around the world. For this reason, it is important for Muslim accountants to develop accounting standards which are specially adapted to Islamic needs, and for Muslim countries to ensure that these are considered by international accounting standard-setting bodies” (Shadia Rahman, 2007).

“However, it must be noted that the *Shariah* standards carry a superior imperative authority derived from the established principle for Islamic financial institutions that they must adhere to the *Shariah*. On the other hand, the accounting standards derive their authority from supervisory agencies adopting and requiring them. This is in addition to the differences between each type in terms of how wide or narrow the need for them may be” (Ghuddah), The principles of “*Amanah*” (Amer, 2007) and “*Shahadat*” (Amer, 2007) and “*Shura*” (Counseling) can provide a sound foundation for a new accounting theory. The teaching of “*Hadith*” on “*bay*” and related matters gives us a clear direction that how transactions could be valued. The underlined principle here is Devine Guidance which in return gives us best possible correct valuation of business transactions. Earlier a mechanism for setting accounting standards was proposed (Amer, 2009) which is modified a little at Figure-1. The points related to Devine Guidance (Amer, 2007), Principles of “*Amanah*” (Amer, 2007) & “*Shahadat*” (Amer, 2008) and “*Shura*” have been discussed earlier. The concept of bay was also discussed in some details earlier (Amer, 2009 & 2010) Here the focus of discussion is application of concept of “*bay*” in the context of accounting standards in lines with the accounting theory based on Islamic principles.

## 2- Literature Review

The subject matter of “*bay*” is very vast. In addition to conceptually, the term “*bay*” has also a very broad scope in application. “In *shariah* terms the meaning of “*bay*” is very broad. The terms of purchase and sale as used cannot truly reflect “*bay*”. Every matter which relates to transaction with each comes under bay” (Kylani). In his book “*Ahkam –e- Tijarat aur Lain Dain ke Masail*” Kylani has discussed various issues related to transactions under fourteen (14) different chapters. Lahori & Albani, (2010) has supported the views of Kylani regarding his point view on broadness of the concept. In *Taqreer-e-Tirmizi*, which is a set of speeches of famous religious scholar Mufti Taqi Usmani (April, 1999) on “*mamalats*”, more than fifty chapters has been included under the heading of “*Abwab-ul-Bayu*” (Chapters of “*Bay*”). In this book important matters related to business, including finance, facing in the present era, has been discussed. The matters include “*riba*” (interest), “*gharaar*” (speculation), installment sale, loan, brokerage, credit, mortgage, money, sale & purchase of shares, holding etc. Similarly in the context of “*bay*” some important financial matters like credit & debit cards, insurance, leasing, copy rights, good will, royalty, trade mark and shares has been discussed by Hafiz Zulfiqar Ali (September, 2008) in his book “*Dur-e -Hazar Key Mali Mamalat Ka Sharai Hukm*”.

If we study the different books of “Hadith” we will find a lot of teachings related to “*bay*”. Here different topics of chapters on “*bay*” and related matters are being presented.

## 2-1 Sahih Bukhari

- 1 Sales and Trade.
- 2 Sales in which a Price is paid for Goods to be Delivered Later (As-Salam).
- 3 Hiring.
- 4 Transference of a Debt from One Person to Another (Al-Hawaala).
- 5 Representation, Authorization, Business by Proxy.
- 6 Agriculture.
- 7 Distribution of Water
- 8 Loans, Payment of Loans, Freezing of Property, Bankruptcy
- 9 Lost Things Picked up by Someone (Luqaata)
- 10 Oppressions
- 11 Partnership
- 12 Mortgaging
- 13 Manumission of Slaves
- 14 Gifts
- 15 Witnesses
- 16 Peacemaking
- 17 Conditions

## 2-2 Muslim

- 1 The Book of Transactions (Kitab Al-Buyu')
- 2 The Book of Gifts (Kitab Al-Hibat)
- 3 The Book of Bequests (Kitab Al-Wasiyya)
- 4 The Book of Oaths (Kitab Al-Aiman)
- 5 The Book Pertaining to the Oath, for Establishing the Responsibility of Murders, Fighting, Requital and Blood-Wit (Kitab Al-Kitab Al-Qasama wa'l-Muharaba wa'l-Qisas wa'l-Diyat)
- 6 The Book Pertaining to Judicial Decisions (Kitab Al-Aqdiyya)

## 2-3 Malik

- 1 Business Transactions
- 2 Qirad
- 3 Sharecropping
- 4 Renting Land
- 5 Pre-emption in Property

## 2-4 Dawud

- 1 Commercial Transactions (Kitab Al-Buyu)
- 2 Wages (Kitab Al-Ijarah)
- 3 Drinks (Kitab Al-Ashribah)
- 4 Foods (Kitab Al-At'imah)
- 5 Model Behavior of the Prophet (Kitab Al-Sunnah)
- 6 General Behavior (Kitab Al-Adab)

## 2-5 Jamia Tirmizi

Under ‘Book of Buying and Selling’ the following chapters have been included:

1. Concerning sale of mudabbar
2. About dislike to receive sellers (outside city)

3. About a city dweller who is not allowed to sell the belonging of a villager
4. Prohibition to sell muhaqalah and muzabanah
5. Disapproval to sell fruit before they are ripe
6. About prohibition to sell the young in a she-camel's womb
7. Fraudulent sale is forbidden
8. Disapproval to combine two transactions in one
9. It is disallowed to sell that which is not in seller's possession
10. It is disapproved to sell wala or to gift it
11. Disapproved to sell animal against animal on credit
12. About buying one slave for two slaves
13. About exchange of wheat for wheat at par, but disapproval for imbalanced exchange
14. About coins
15. About selling dates after fertilising and slave who has wealth
16. Option to both parties before they separate
17. (No Caption)
18. About one who is deceived in a (sale) transaction
19. About an animal who was not milked
20. About placing condition to ride animal while selling it
21. To obtain benefit from that which is pledged
22. Buying a necklace with gold and gems
23. About condition wala when setting free a male or female slave
24. (No Caption)
25. About the mukatab who can pay for his freedom
26. If a debtor becomes a pauper but has with him his property
27. About prohibition to a Muslim to hand over wine to a dhimmi to sell it for him
28. (No Caption)
29. It is necessary to return that which is borrowed
30. About hoarding grain
31. Selling animals whose milk is accumulated
32. About appropriating a Muslims property after taking a false oath
33. About what happens if buyer and seller dispute
34. About selling excess water
35. About disapproval of payment for pairing male with female
36. About price paid for a dog
37. About earnings of a cupper
38. About permission to pay wages to the cupper
39. About dislike for the price paid for dogs and cats
40. (No Caption)
41. About disapproval of sale of singers
42. About disapproval to separate brothers or mother and child while selling them
43. About one who finds defect in a slave he buys after he gets him to do some work
44. About one who passes by the fruit having permission to eat them
45. About disapproval to allow exception in bargain
46. About disapproval to sell grain before taking possession
47. About disapproval to make an offer against a brothers offer
48. About selling wine and prohibition to do that
49. Prohibition to prepare vinegar from wine
50. Milking animals without permission of their masters
51. About selling hide of dead animals and idols
52. About disapproval to take back a gift
53. About al-Araya and its permissibility
54. More about it

55. About disapproval for najsh
56. About weighing down the scale
57. About showing leniency to the hard pressed debtor
58. Delayed repayment of debt by a rich person is unjust
59. About the sale munabazah and mulamasah
60. To pay in advance for grain and dates
61. If a partner wishes to sell his share in a land
62. About mukhabarah and mu'awamah
63. About borrowing
64. About adulteration
65. About borrowing a camel or any other animal
66. (No Caption)
67. It is disallowed to buy and sell in a mosque

### 3- Coming to the Point of Setting Accounting Standards

I think our first step on setting accounting standards should be setting qualitative standards which more emphasis on ethical and accountability aspects. Then we go for standards relating to transactions not allowed. Next should be standards relating to valuation standards. In the last we may go for reporting standards. For example based on Jamia Tirmizi we can group the following Hadith in these groups.

#### 1- Standards Related to Quality of Standards

- i. About Shunning Doubts.
- ii. Concerning merchants and the Prophet's name for them.
- iii. About weighing down the scale

#### 2- Standards Related to Transactions Not Allowed

- i. Concerning Consuming Interest.
- ii. About disapproval to allow exception in bargain.
- iii. About disapproval to sell grain before taking possession.
- iv. About disapproval to make an offer against a brother's offer
- v. About selling wine and prohibition to do that
- vi. Prohibition to prepare vinegar from wine.
- vii. It is disallowed to buy and sell in a mosque.

#### 3- Standards Related to Valuation of Standards.

- i. If a debtor becomes a pauper but has with him his property.
- ii. About showing leniency to the hard pressed debtor.
- iii. If a debtor becomes a pauper but has with him his property.
- iv. Delayed repayment of debt by a rich person is unjust.
- v. To obtain benefit from that which is pledged

#### 4- Standards Related to Financial Reporting.

- i- About Warning Against Lying and False Testimony.
- ii- One who swears falsely on his wares

Similarly in "Muslim", a book of "*Hadith*", "The Book of Transactions (Kitab Al-Buyu)" can be studied in this context and the "*Hadith*" can be grouped into these standards. Likewise the topics of various "*Hadith*", as indicated in the literature review and others can be viewed with reference to these four groups of proposed standards. In net shell we may study all "*Hadith*" available on "*bay*" and related topics in the context of making a new set of accounting standards based on Islamic teachings and accounting principles like Amanah, Shahadat, "*Shura*", "*Al-Adal*" and "*Al-Ihshan*".



#### 4-Conclusion

These are some initial thoughts which may be deliberated extensively in lines with the mechanism for setting accounting standards as proposed at figure-1. This has been further modified as to the effect of proposed type of standards at figure-2. As suggested at figure-3, in this regard a cluster approach may be followed in lines with the concept of “*shura*” (Mutual Consultation) in Islam. It is proposed that as a first step a “*Majlis-e- Shura*” (Body of mutual consultation) may be formed at OIC level. Initially a task force consists of Shariah scholars, accounting & finance professionals, entrepreneurs and government representatives from Muslim Umah can be constituted at the forum of OIC to do ground work and facilitate the job to create an international body for the purpose. The new accounting theory based on Islamic principles and accounting standards, as discussed here can be taken as initial framework for deliberation for the purpose. Due to a very wide scope, the author strongly recommends the need to explore more and more the concept of “*bay*” and related topics as available in all books of “*Hadith*” for achieving the objective.

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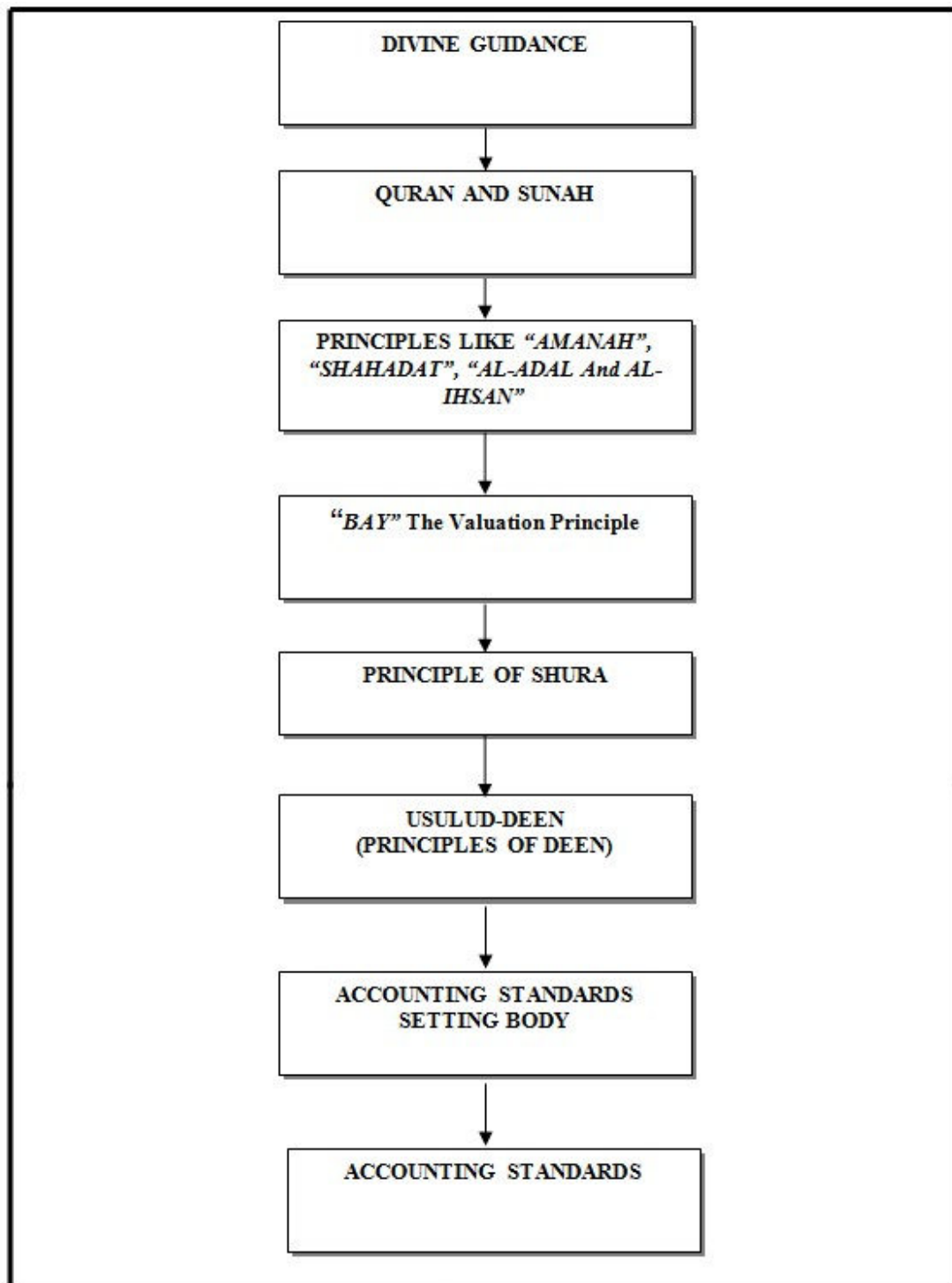
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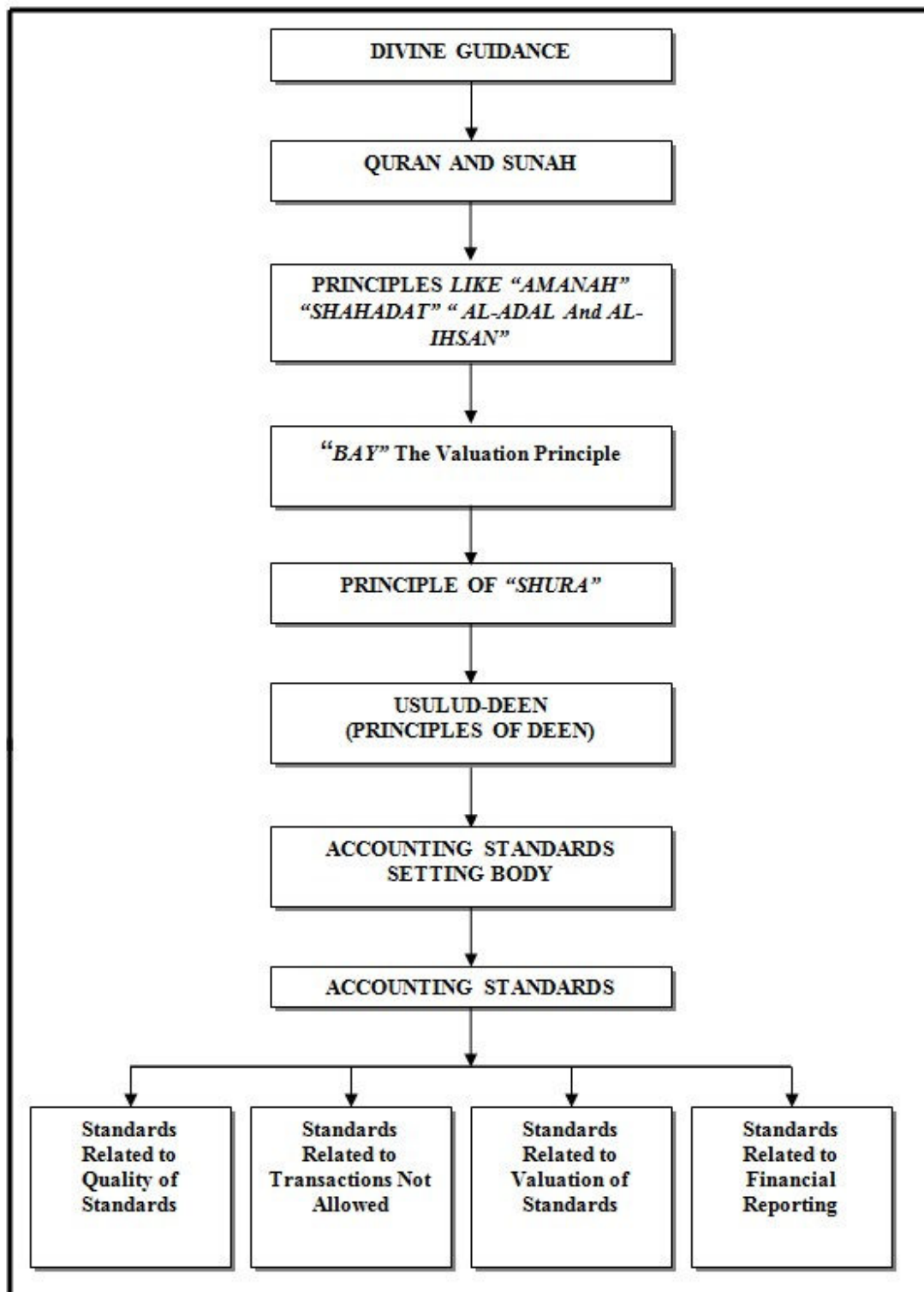


**Mechanism For Setting Accounting Standards**

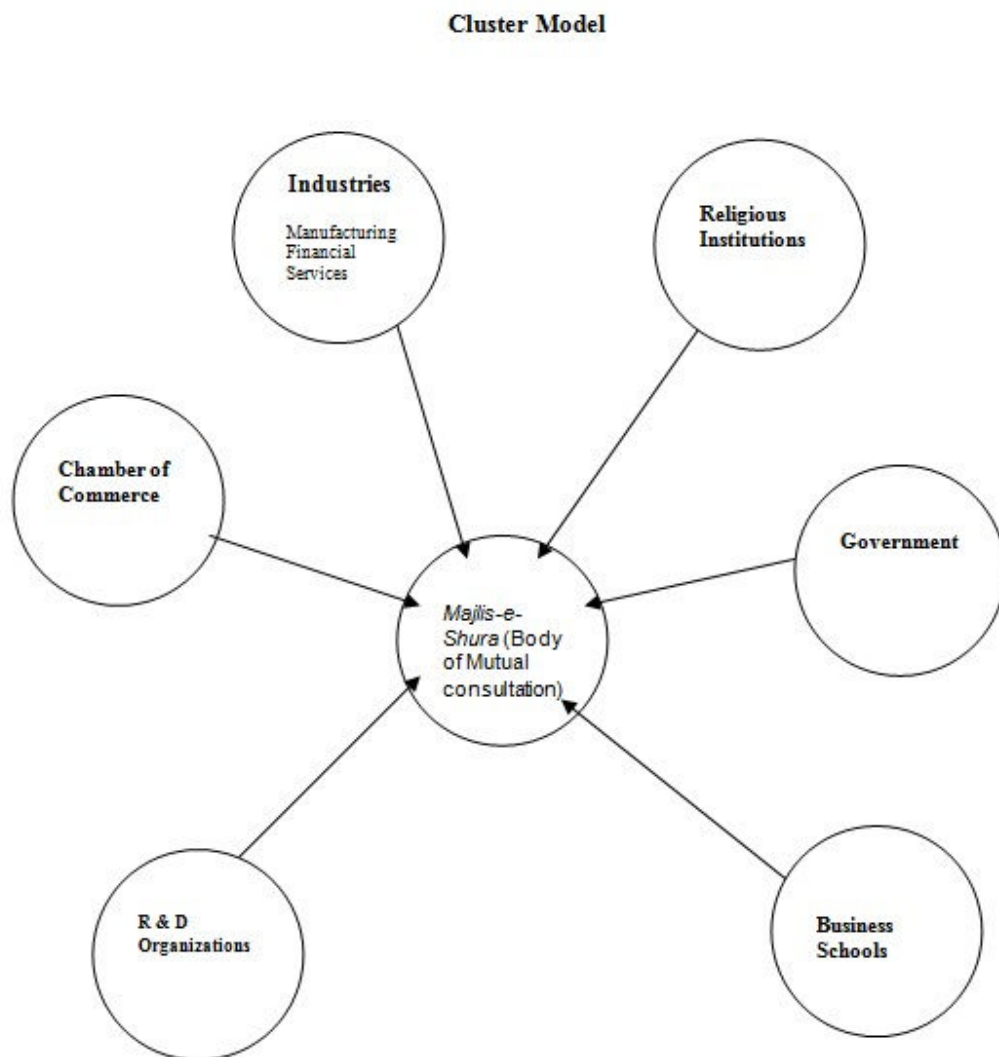


**Figure-1**

**Mechanism For Setting Accounting Standards**



**Figure-2**



**Figure-3**